

Message Text

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FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 8696

INFO AMCONSUL HONG KONG

C O N F I D E N T I A L SECTION 1 OF 2 SEOUL 1470

HONG KONG FOR REGFINATT

EO 11652: GDS

TAGS: EFIN, IMF, KS

SUBJECT: IMF CONSULTATIONS ON STANDBY AGREEMENT

REF: SEOUL 1190

SUMMARY: IMF MISSION HEADED BY JOACHIM AHRENSDORF
AGREED WITH ROKG OFFICIALS DURING FEB. 15-MARCH 1
CONSULTATIONS ON 1975 STANDBY AGREEMENT SUBJECT TO IMF
BOARD APPROVAL. AGREEMENT PROVIDES FOR SECOND TRANCHE
DRAWING OF SDR 20 MILLION (DOLS 24 MILLION) AND MID-YEAR
REVIEW IN JULY. MAIN ISSUE BETWEEN ROKG AND IMF WAS
SIZE OF DOMESTIC CREDIT INCREASE, WHICH WAS RESOLVED
THROUGH LIBERAL FIRST-HALF INCREASE TO BE FOLLOWED BY
SMALL SECOND-HALF INCREASE SUBJECT TO JULY REVIEW.
MAIN CONCERN OF FUND MEMBERS WAS SERIOUS FOREIGN EXCHANGE
SITUATION CREATED BY SHORT-TERM FINANCING OF LARGE BOP
DEFICITS. KOREANS HOPE TO BORROW FROM BOTH IMF OIL
FACILITY AND IMF EXTENDED FACILITY IN 1975 BUT SUCH
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CREDITS WOULD COME MAINLY IN SECOND HALF, TOO LATE

TO MEET CRITICAL FIRST HALF NEEDS. END SUMMARY

1. DOMESTIC CREDIT: THIS MAIN ISSUE WAS RESOLVED BY GIVING KOREANS DESIRED FIRST HALF INCREASE OF 23.4 PERCENT WHILE LIMITING FULL 1975 INCREASE TO 31.2 PERCENT, OR LESS THAN 38 PERCENT ORIGINALLY PROPOSED BY KOREANS. SINCE KOREA HAS BREACHED CEILINGS IN LAST 3 YEARS, E.G., CREDIT UP 53.8 PERCENT IN 1974 COMPARED TO ORIGINAL CEILING OF 32.2 PERCENT, THIS IS HOLDING ACTION UNTIL MID-YEAR TEAM CAN REVIEW SITUATION. NO CHANGE LIKELY IN INTEREST RATES; IMF MISSION CONSIDERED THEM TOO LOW RELATIVE TO INFLATION BUT KOREANS INSISTED HIGHER RATES WOULD HURT EXPORTS AND DESIRED DOMESTIC INVESTMENT.

2. GOVERNMENT BORROWING: IMF MISSION ALSO AGREED TO VERY STIMULATIVE FISCAL POLICY IN FIRST HALF ON BASIS OF PROJECTED RETRENCHMENT IN SECOND HALF. GOVERNMENT CREDIT FROM CENTRAL BANK CAN INCREASE 124 PERCENT IN FIRST HALF BUT IS PROJECTED TO DECREASE BY 4 PERCENT IN SECOND HALF. ABOUT ONE-THIRD OF THE ESTIMATED FIRST HALF INCREASE TOOK PLACE IN JANUARY. NO SPECIFIC CEILING WAS SET FOR DEFICIT OF GRAIN MANAGEMENT FUND, AND IMF OBTAINED ONLY GENERAL PLEDGE THAT GOVERNMENT GRAIN PRICES TO CONSUMERS WILL BE RAISED WHEN APPROPRIATE. (GMF ANNUAL DEFICIT ROSE FROM 65 TO 147.5 BILLION WON IN 1974, AND 1975 DEFICIT CEILING IS SET AT 180 BILLION WON, WHICH WOULD USE MORE THAN HALF OF TOTAL 1975 GOVERNMENT BORROWING OF 268 BILLION WON AGREED TO BY IMF.) IN ADDITION, SEPARATE FERTILIZER SUBSIDY AGENCY ESTIMATED TO BORROW 67 BILLION WON, ALTHOUGH 78.5 BILLION WAS BORROWED THROUGH FEBRUARY, PARTLY TO FINANCE 1974 DEFICIT IN EXCESS OF AUTHORIZED 20 BILLION WON. IN VIEW OF POOR EXPORT PROSPECTS AND THE NEED TO RESTRAIN DOMESTIC DEMAND FOR IMPORTS, THE MISSION SUGGESTED THAT THE GNP GROWTH TARGET OF 7 PERCENT BE LOWERED.

3. FOREIGN BORROWING AND RESERVES: IMF MISSION VIEWED CURRENT FX SITUATION AS SERIOUS AND AGREED WITH KOREANS THAT MORE LONG-TERM AND LESS SHORT-TERM BORROWING NEEDED IN 1975. CONFIDENTIAL

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DRAFT STANDBY PROVIDES FOR DOLS 1.79 BILLION IN 1-15 YEAR TERM NON-BANK BORROWING (CONTRACTED BASIS) IN 1975, OF WHICH UP TO DOLS 300 MILLION MAY BE ON 1-3 YEAR TERM. (THESE ARE APPROXIMATE MAXIMUM ESTIMATES OF ROKG.) DUE TO BOP UNCERTAINTIES AND KOREAN RELUCTANCE TO MENTION LARGE NEGATIVE NET FOREIGN ASSET POSITION IN LETTER OF INTENT, MISSION AGREED TO FOREGO USUAL SEMI-ANNUAL TARGET FIGURES FOR FOREIGN ASSETS. WE UNDER-

STAND NET POSITION (INCLUDING LONG-TERM LIABILITIES)
WAS ABOUT MINUS DOLS 500 MILLION IN LATE FEBRUARY,
COMPARED TO MINUS DOLS 408 MILLION AT END JANUARY.

4. IMF CREDITS: KOREANS ARE EXPECTED TO DRAW 60
PERCENT OF THEIR SECOND CREDIT TRANCHE OF DOLS 24
MILLION WHEN STANDBY APPROVED, PROBABLY IN APRIL.
REMAINDER CAN BE DRAWN AFTER MID-YEAR REVIEW. MAIN
KOREAN EMPHASIS RE IMF THIS YEAR WILL BE ON (1)
MAXIMUM DRAWINGS UNDER OIL FACILITY AND (2) SECURING
ELIGIBILITY FOR NEW EXTENDED FACILITY. MAIN FACTOR
DETERMINING SIZE OF (1) WILL APPARENTLY BE TOTAL
FUNDING OF OIL FACILITY SINCE KOREANS WON CASE FOR
ABOVE-QUOTA TREATMENT LAST YEAR. KOREANS HOPE TO
QUALIFY FOR EXTENDED FACILITY DRAWINGS IN LATE 1975
OR EARLY 1976 ON BASIS 3-YEAR PROGRAM (TO BE SUB-
MITTED LATER THIS YEAR) FOR ADJUSTING TO STRUCTURAL
PROBLEMS CAUSED MAINLY BY OIL CRISIS.

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C O N F I D E N T I A L SECTION 2 OF 2 SEOUL 1470

5. EXCHANGE RATE: NO EARLY CHANGE IN RATE FORESEEN.
DECEMBER DEVALUATION COMPENSATED FOR INFLATION,
PREVENTED FURTHER DETERIORATION IN FX SITUATION AND

IMPROVED PROFITABILITY OF EXPORT FIRMS, WITHOUT NOTICEABLE EFFECT ON EXPORT ORDERS OR IMPORT LICENSES. IDEA AT TIME OF DECEMBER DEVALUATION RE FUTURE SHIFT TO FLOATING RATE HAS NOW BEEN DROPPED, MAINLY BECAUSE IMF PREFERS GREATER CONTROL AFFORDED BY SPECIFIC CHANGES.

6. IMPORT RESTRICTIONS: MISSION FOUND THERE HAD BEEN NET INCREASE IN RESTRICTIVENESS IN 1974, ALTHOUGH SOME LIBERALIZING ACTIONS WERE UNDERTAKEN IN CONNECTION WITH DECEMBER DEVALUATION. EXPORT INCENTIVES WERE ALSO SOMEWHAT REDUCED (THROUGH HIGHER INTEREST RATE ON IMPORTED MATERIALS) AT THAT TIME BUT FIRST OF SEVERAL MEASURES FAVORING IMPORT SUBSTITUTION WAS ALSO INTRODUCED. RECENT INDIRECT RESTRICTIONS ON IMPORTS CAN BE EXPECTED TO BE SUPPLEMENTED DURING 1975, PROBABLY IN FORM ADMINISTRATIVE DISCRETION IN LICENSE APPROVALS. DIRECT CONFIDENTIAL

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IMPORT RESTRICTIONS ARE RULED OUT BY OIL FACILITY UNDERTAKINGS.

7. COMMENT: ALTHOUGH DOMESTIC CREDIT INCREASE WAS MAIN ISSUE DURING IMF CONSULTATIONS, MAIN CONCERN OF FUND MEMBERS WAS SERIOUS FX SITUATION. IMF RESIDENT REP. BELIEVES KOREANS MAY BE FORCED IN NEXT SEVERAL MONTHS TO INCREASE SHORT-TERM FOREIGN BANK BORROWINGS ABOVE GROSS RESERVE FIGURE. CREDIT LINES ARE AVAILABLE BUT THEIR USE COULD TRIGGER CRISIS OF CONFIDENCE AMONG FOREIGN LENDERS AND REQUIRE IMF INVOLVEMENT BEFORE JULY REVIEW. AS REPORTED REFTEL, KOREAN SHORT-TERM REFINANCE CREDITS (NEARLY ALL WITH U.S. BANKS) WERE ALMOST EQUAL TO GROSS RESERVES IN LATE FEBRUARY. BEST SOLUTION FOR KOREANS CONTINUES TO LIE IN LONG-TERM CASH LOANS FROM OPEC SOURCES. WHILE THESE BEING ACTIVELY EXPLORED, NO MAJOR LOANS APPEAR IMMINENT. SNEIDER

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